In the

United States Court of Appeals

FOR THE NINTH CIRCUIT

No. 22598

REPUBLIC NATIONAL LIFE INSURANCE COMPANY,
Appellant,

v.

HAMILTON LIFE INSURANCE COMPANY OF NEW YORK and FINANCIAL SECURITY LIFE INSURANCE COMPANY,
Appellees.

APPELLANT'S REPLY TO BRIEF OF APPELLEES

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To the Honorable Court of Appeals:

Appellant, Republic National Life Insurance Company, respectfully requests leave to file this its Brief in reply to Brief filed by Appellees.

I.

HAMILTON'S ARGUMENT MISCONSTRUES THE FEDERAL ARBITRATION ACT TO PRECLUDE THE CAUSE OF ACTION ALLEGED IN REPUBLIC NATIONAL'S COMPLAINT AND TO DENY DUE PROCESS OF LAW.

By characterizing the issues of this case as merely a dispute over the venue of two District Courts under 9 U.S.C.

Sections 3 and 4, Hamilton has obscured the nature of the case. The Complaint alleges a three-party reinsurance contract was formed providing for two successive cessions of insurance. As originating company Hamilton ceded 80 percent to Republic National specifically subject to the prior agreement that Republic National would in turn cede 80 percent (or 64 percent of the original insurance) to Financial Security, to accomplish a division of risk to be borne 20 percent by Hamilton, 16 percent by Republic National, and 64 percent by Financial Security. (See also Boles Affidavit, A.R. 69). By contrast, if Hamilton is permitted to disregard the Complaint and restrict a subsequent adjudication only to Hamilton and Republic National, in the absence of Financial Security, Republic National's potential liability exposure sharply increases to 80 percent of the total, while Hamilton's share of the risk remains constant.

Therefore, without so much as a single ruling on any issue of proof, Hamilton proposes to shut the door to the determination of Republic National's claims stated in the Complaint. Contrary to Hamilton's assurances, the New York forum cannot adjudicate Republic National's claimed right to obtain a determination of its net liability as among the three insurers. (Appellee's Brief p. 7-8). It is no answer to say that in a subsequent proceeding Republic National can attempt to mitigate any loss it sustains through a two-party proceeding. The injustice inherent in such a procedure is that Financial Security could then maintain that the action by Republic National was barred by the absence of Hamilton as an indispensable party.

Any such fundamental restructuring of Republic National's claimed right of recovery, without even the most basic evaluation of the evidence, threatens denial of due process of law. Throughout the recent cases interpreting the Federal Arbitration Act are repeated expressions of concern that considerations of expediency not be allowed to precipitate denials of due process in determining arbitrability. *Bernhart v. Polygraphic Co. of America*, 350 U.S. 198, 76 S. Ct. 273 (1956); *Moseley v. Electronic & Missile Facilities*, 374 U.S. 171, 83 S. Ct. 1815 (1963); *Prima Paint Corp. v. Flood & Conklin Mfg. Co.*, 388 U.S. 395, 87 S. Ct. 1801, 1808 (1967); *Collins*, Arbitration and the U.C.C., 41 N.Y.U. L. Rev. 736 (Oct. 1966); *Bernstein*, The Impact of the U.C.C. Upon Arbitration; Revolutionary Overthrow or Peaceful Existence, 42 N.Y.U. L. Rev. 8 (March 1967); Scope of the U. S. Arbitration Act in Commercial Arbitration: Problems in Federalism, 58 Northwestern U. L. Rev. 468 (Sept.-Oct. 1963); Judicial Control of the Arbritrators Jurisdiction: A Changing Attitude, 58 Northwestern U. L. Rev. 521 (Sept.-Oct. 1963); *Kronstein*, Arbitration is Power, 38 N.Y.U. L. Rev. 661 (June 1963). The corollary to this is the Court's requirements that stays under 9 U.S.C. Section 3 be determined upon decided fact. *Engineers Assoc. v. Sperry Gyroscope Co.*, 251 F. 2d 133 (2d Cir. 1957); *Kulukundis Shipping Co. v. Amtorg Trading*, 126 F. 2d 978, 988 (2d Cir. 1942); *Prima Paint Corp. v. Flood & Conklin Mfg. Co.*, 388 U.S. 395, 87 S. Ct. 1801 (1967). This in turn prevents parties, such as Republic National, from being stripped of their justiciable controversies without hearing, as Hamilton now appears content to do.

In this light the *Kerotest* doctrine (Appellant's Brief pp. 23-28) is more than a mere aid to efficient judicial administration; rather it is the cornerstone of due process. Ignoring it as Hamilton proposes would bar for all time Republic National's attempts to establish the three-party contractual arrangement pleaded in its Complaint. On the other hand, if by reliance on the Kerotest doctrine the procedural cart and horse are put back in proper order, the nature of the contract and the parties' relationships with respect to arbitration can be determined by applying the law to the facts placed of record. Then, if under the facts the District Court is " * * * satisfied that the issue involved in such suit or proceeding is referable to arbitration under such an agreement, * * * it may stay the trial of the action until such arbitration has been had in accordance with the terms of the agreement. * * * " 9 U.S.C., Section 3.

Republic National is as entitled to have an equal opportunity to show that the issue involved in this action is not referable to arbitration as Hamilton is to show the opposite. This can only be accomplished by resolving questions of fact. But to date every such effort has been disregarded in deference to the Hamilton theory that arbitration agreements outweigh all considerations of fact and relevancy. (See Motion for Partial Summary Judgment, A.R. p. 63). Instead, with respect to the Court's duty in passing on stays requested under 9 U.S.C., Section 3, it is said:

> "In construing the provisions of the Federal Arbitration Act, we have stated that after determining that the parties have entered into an arbitration agreement,

> the duty of the court is to determine 'whether any of the issues raised in the suit were within the reach of that agreement.' Kulukundis Shipping Co. v. Amtorg Trading Corp., 2 Cir., 1942, 126 F. 2d 978, 988. This duty cannot be adequately performed unless the court examines the facts upon which the demand for arbitration is based as those facts relate to the language of the agreement." Engineers Ass'n. v. Sperry Gyroscope Co., etc., 251 F. 2d 133, 137 (2d Cir. 1957).

II.

NO DISCRETIONARY STAY WAS GRANTED BY THE DISTRICT COURT.

Hamilton has branded the order appealed from as prima facie invalid by attempting to support the order by a rationale inconsistent with the District Court's. The Court stated:

> "The Court has considered plaintiff's motion for rehearing and in the alternative for stay pending appeal. The Court has reviewed again the various memoranda submitted by both parties and the authorities cited therein. The Court is still convinced that the whole statutory scheme of proceedings provided for in the Federal Arbitration Act contemplates that under a procedural situation such as in this case, this Court being satisfied that on the face of the pleadings there is a written contract involving commerce with disputed issues under the contract that come within the scope of the arbitration clause contained in the contract, defenses (factual and legal) to a charge of refusal to arbitrate should be heard and determined in connection with the petition to compel arbitration pending in the District where arbitration is contemplated by the terms of the contract." A.R. p. 101.

Rather than to show a basis in law for this order under 9 U.S.C., Section 3, Hamilton states that the Court *could*

have achieved the same result by an exercise of discretion. (Appellee's Brief, Point III). To reach this result one must first totally ignore the record. Hamilton's original Motion for Stay of Proceedings Pending Arbitration (A.R. p. 10) bases its request on 9 U.S.C., Section 3 (Motion p. 3, A.R. p. 12). Subsequently, in its Memorandum in Support of Motion for Stay, Hamilton set forth the discretionary stay theory. (A.R. p. 41). Then, the discretionary stay concept was argued to the Court in the January 8, 1968 hearing. (Transcript, p. 20, l 23-21, l 11; p. 23, l 21-24, l 16). At that hearing the Court stated:

> "The thing that concerns me, Mr. Frank, on which I am going to do a little more work is that I don't see that this court can grant a stay pursuant to a particular statute unless it first implicitly finds that the statute applies." (Transcript, p. 22, l 7-11).

It is obvious that no considerations of discretion entered into the orders appealed from which clearly relates only to 9 U.S.C., Section 3.

Also, justifying the order upon the grounds of discretion is abhorrent to logic. Carried to its logical ends, Hamilton's argument means that no stay entered in reliance on 9 U.S.C., Section 3, no matter how misconceived, would constitute reversible error. The precedents are to the contrary. *Ets-Hokin & Galvan, Inc. v. United States ex rel. Albert S. Pratt, Inc.*, 350 F. 2d 871 (9th Cir. 1965); *American Safety Equipment Company v. J. P. McGuire & Co.*, 391 F. 2d 821 (2d Cir. 1968);

Nor can a Court discreetly achieve a result which is contrary to due process of law as previously discussed. The concept of the abuse of judicial discretion is discussed in *Martin v. Graybar Electric Company*, 266 F. 2d 202, p. 204:

> "Two simultaneously pending lawsuits involving identical issues and between the same parties, the parties being transposed and each prosecuting the other independently, is certainly anything but conducive to the orderly administration of justice. We believe it to be important that there be a single determination of a controversy between the same litigants and, therefore, a party who first brings an issue into a court of competent jurisdiction should be free from the vexation of concurrent litigation over the same subject matter, and an injunction should issue enjoining the prosecution of the second suit to prevent the economic waste involved in duplicating litigation which would have an adverse effect on the prompt and efficient administration of justice unless unusual circumstances warrant. As none such appears in this record, we agree with what would seem to be the established general rule that the party filing later in time should be enjoined from further prosecution of his suit. Milwaukee Gas Specialty Co. v. Mercoid Corporation, 7 Cir., 1939, 104 F. 2d 589, 592; Crosley Corporation v. Hazeltine Corporation, 3 Cir., 1941, 122 F. 2d 925, 929; Cresta Blanca Wine Co. v. Eastern Wine Corporation, 2 Cir., 1944, 143 F. 2d 1012, 1014; Independent Pneumatic Tool Co. v. Chicago Pneumatic Tool Co., 7 Cir., 1948, 167 F. 2d 1002, affirming D.C., 74 F. Supp. 502; Speed Products Co. v. Tinnerman Products, 1948, 83 U.S. App. D.C. 243, 171 F. 2d 727, 730."

Since Hamilton can perceive no justification for the Court's order on its face, it should be reversed.

III.

THE McCARRAN QUESTION.

Hamilton argues that the McCarran Act has been narrowly limited in its application. The scheme of the McCarran Act was to provide that insurance companies be subject to state law and not federal law unless that federal law was specifically made applicable to the business of insurance. The Act does not require the presence of a precise and specific state statute relating solely to insurance companies in order to defeat federal supremacy. The Act, in Section 2(a) and (b), calls for federal subordination, subject to certain exceptions contained in Section 4. On this question it is interesting to note the debate contained in the Congressional Record as follows:

> "Mr. RADCLIFF. I agree with the Senator from Utah that the statement in subsection (a) of section 2 is quite definite and clear. But it has seemed to those who have been working upon this bill that there was some need or at least advisability that there should not be any repeal by implication. The statement beginning on page 1 is a general statement setting forth the purposes.
>
> "Since there seems to be doubt in the minds of certain people that there might be repeal by implication or that a general statement might have some crimping effect, it would not be at all unusual if a saving clause were put in the bill. It may not be necessary, but in the spirit of caution I think it might be desirable, especially knowing the very serious problems which have been confronting the insurance companies and the various States to leave them free to meet conditions some of which cannot now be foreseen. * * *"

"Mr. O'MAHONEY. Does not subsection (a) of section 2 take complete acount of that fact, and grant complete protection to existing State laws?

"Mr. FERGUSON. I agree that, as to existing State laws, subsection (a) of Section 2 does so provide.

"Mr. O'MAHONEY. Let me read it: 'The business of insurance, and every person engaged therein, shall be subject to the laws of the several States which relate to the regulation or taxation of such business.' That is complete.

"Mr. FERGUSON. I think that is correct.

"Mr. O'MAHONEY. There is no reason for misunderstanding on the part of any State official or any insurance company or any policyholder with respect to the meaning of that subsection as it applies to existing law.

"Mr. FERGUSON. As it applies to existing law, that is correct. However, subsection (b) provides for something further. It provides that no Federal legislation relating to interstate commerce shall by implication repeal any existing State law unless such act of Congress specifically so provides.

"Mr. O'MAHONEY. The Senator puts his finger upon the precise center of this dispute, or misunderstanding. Let me say to the Senator that, recogizing the complexity of this problem, and the desirability of maintaining State regulation and State taxation, members of the Judiciary Committee who were opposed to the proposal to grant a blanket exemption from the antitrust laws desired to go as far as was humanly possible in the direction of giving the States a clearcut opportunity to adjust State laws in acordance with Supreme Court decisions and the antitrust laws.

"It is no secret that Senate Bill 12, introduced by the Senator from New Mexico (Mr. Hatch) and myself, and Senate Bill 340, the bill which was reported by the committee, are modifications of a measure which

> was originally drafted by the legislative committee of the National Association of Insurance Commissioners. So there was an effort to work with those groups. In drafting those two bills we sought to spell out each particular law which might apply to insurance. We referred specifically to the Federal Trade Commission Act, the Robinson-Patman Act, the National Labor Relations Act, and the Fair Labor Standards Act. In other words, a good-faith attempt was made to specify every single law which had an application or might have an application, to insurance.
>
> "Section 2(b) was drafted and written into the bill which I introduced, in the belief, not that it would be interpreted as an additional exemption from the antitrust laws, but that it would be a sort of catch-all provision to take into consideration other acts of Congress which might affect the insurance industry, but of which we did not have knowledge at the time. * * *" Congressional Record-Senate, January 25, 1945, Page 483.

The limits on McCarran have been applied in areas where exceptions were imposed, such as the Clayton Act and the Robinson-Patman Act, *U. S. v. Chicago Title & Trust Co.*, 242 F. Supp. 56 (N.D. Ill. 1965), and the Federal Trade Commission cases cited in Appellant's Original Brief. This Congressional intent has recently been displayed by the precise provisions for including insurance companies in the application of Securities Regulation Statutes, as evidenced by the 1964 Amendments referred to in the opinion of this Honorable Court in the National Security case.

Apart from these considerations, Hamilton appears to seek affirmance of the Arizona orders on the ground that the

damage has already been done through decision of the two-party issues in New York. However, the issue here is fundamental jurisdiction, and the error of the Arizona Court is only enlarged by the furtherance of the bilateral proceedings in derogation of Republic National's preexisting and preeminent right to have the proceedings on the issues framed by its Complaint pursued. Questions of conflicts of laws, indispensable parties, and contested issues of fact discussed in the opinion of the New York Court can be considered upon their merits in the due course of that action. They are no part of this record on appeal and cannot now be properly discussed here.

CONCLUSION

The orders of the District Court are not supported by 9 U.S.C., Section 3, although clearly issued in reliance upon the statute. Hamilton bases its hopes for affirmance only upon discretion which cannot be exercised contrary to the requirements of the statute. To accept the Hamilton position would negate basic concepts of due process which have long been of concern in interpreting the Federal Arbitration Act. The McCarran Act, both as interpreted by the Court and as established by its legislative history, demonstrates an intention to exempt the insurance business from the Federal Arbitration Act. Therefore, this case should be re-

manded to the District of Arizona with instructions to proceed with a determination of the issues pursuant to that exemption.

Respectfully submitted,

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Copies of the foregoing Brief have been served by mail this 21 day of Aug., 1968, upon Mr. John P. Frank of the firm of Lewis, Roca, Beauchamp & Linton, 114 West Adams Street, Phoenix, Arizona 85003, Attorneys for Appellees.

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